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DECEMBER 1951

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

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The Canadian Chartered Accountant

VOLUME 59 DECEMBER 1951 NUMBER 6

Message de Noel de Votre President

CHAQUE année, à l'approche des fêtes de Noël et du Jour de l'An, il est de coutume de regarder en arrière sur l'année qui se termine, d'espérer des choses meilleures pour celle qui s'en vient et surtout de prendre de bonnes résolutions.

Il semble que nous soyons encore bien loin d'atteindre l'atmosphère de paix dans le monde comme nous nous l'étions souhaité l'an dernier; les derniers événements internationaux ont agravé plutôt qu'amélioré les relations entre les peuples de l'univers.

Toutefois il y a quelque chose de consolant et de rassurant, c'est qu'en notre pays, tout comme chez nos voisins du Sud, nous réalisons pleinement le danger que nous courons et le devoir qui nous incombe de sauvegarder la paix dans le monde. L'année qui s'achève a marqué un progrès remarquable dans ce sens et ce n'est qu'en persistant dans cette voie que nous pourrons continuer de jouir de la paix et de la sécurité que nous avons le bonheur de posséder dans notre jeune pays.

Notre profession est intimement liée au développement de notre pays et chacun d'entre nous doit se faire un devoir de contribuer à son succès.

C'est dans ces sentiments, mes chers confrères, qu'à titre de Président de votre Institut, je vous offre mes meilleurs voeux à l'occasion des fêtes de Noël et du Nouvel An.

EVERY year at Christmas time, it is the custom to give a last glance back at the year which has gone by and to look forward to the new year with new hope and an eagerness to carry out the resolutions which we have taken.

It seems that the Peace on Earth we had wished for the world last year is still far from our reach; the most recent international events have injured rather than improved the relations between the peoples of the world.

However, there is some comfort in the fact that in our country, as well as in the United States, our good neighbours, we have come to realize the danger and are ready to accept responsibility for safeguarding peace in this world. The year which is now ending has shown remarkable progress towards this end, but it is only by constant effort on our part that we shall continue to enjoy that peace and security which our young country possesses.

Our profession is intimately linked with the development of our country and every one of us should do his utmost to contribute to its success.

It is with these feelings, my dear colleagues, that, as your president for the coming year, I offer to each of you my best wishes for a Merry Christmas and a Happy New Year.

A. EMILE BEAUVAIS
President
L'Institut des Comptables Agréés du Canada

COMMENT AND OPINION

The President's Tour of the Atlantic Provinces

MR. A. E. BEAUVAIS, president of the Canadian Institute, accompanied by Madame Beauvais and Mr. Clem L. King visited three of the four Atlantic Province Institutes during the month of October. The Provinces visited were Prince Edward Island, Newfoundland, and New Brunswick. We are informed that this is the first time in some years that a C.I.C.A. president from another part of Canada has visited the Atlantic Institutes during his term of office.

In Britain and the United States it has long been the custom for the presidents of the leading accounting societies to call on provincial and state branches of their respective societies during their year of office. Indeed, we gathered from Mr. T. Coleman Andrews, president of the American Institute of Accountants, who graced our last annual meeting at Banff with his presence, that calling on the State societies and delivering addresses was his principal occupation during his term of office. In Canada, however, this practice has not been a feasible one, for here as in so many other instances we have had to face the twin obstacles of great distances and a thinly scattered population. These obstacles are daily diminishing in inverse ratio to the growth of the country in population and wealth, and of course the accounting profession has been enormously stimulated by the economic revolution which in recent years has converted Canada from a nation of primary producers to a highly integrated industrial and commercial community.

We understand that it is Mr. Beauvais' intention to visit all of the provincial Institutes during his term of office, and if he succeeds in that rather arduous (though no doubt pleasurable) task, he will, we believe, have equalled a record set a few years ago by one of his predecessors, though of course some earlier presidents came not far short of this objective.

Auditors and Inventories
Bulletin No. 7

THE TEXT of the recently issued Bulletin No. 7, "The Auditor's Responsibility for the Validity of the Inventory Figure", of the Committee of Accounting and Auditing Research appears on pages 261 to 264. The Committee is of the opinion that the phrase "as determined and certified by the management" or to like effect, which may appear on balance sheets in connection with inventories, does not relieve the auditor of responsibility for the validity of the inventory figure since any such phrase can only be regarded as part of the financial statements upon which the auditor is expressing an opinion.

The bulletin points out that the auditor must determine, in the light of the circumstances of each case, those inventory procedures which he must undertake to enable him to express an opinion.

According to the Committee, generally accepted auditing procedures in Canada in respect of inventories include a review of the methods followed by the client in determining inventory quantities and values, the testing of quantities with confirmatory evidence such as rough count sheets, perpetual stock records and the testing of the pricing of the inventory and clerical accuracy. The tests must be sufficient in scope to satisfy the auditor that the stated basis of inventory valuation is being followed and to determine if the basis is consistent with that of the preceding year.

Certain Aspects of Workmen's Compensation Administration

By J. P. French, B. Com., C.A.

Many problems have been solved but new ones will be met as a broader scope of service is provided to industry

SOME THIRTY-FIVE YEARS have elapsed since the first workmen's compensation legislation was passed in Canada. Workmen's compensation laws were developed to protect the employer, the employee, and the public generally from the prevalent hardships and evils frequently encountered prior to their enactment. The advantages derived by the employer are two-fold:—

1. relief from the costly and time-wasting tangle of litigation arising out of personal injury is given, as the various Acts are in lieu of all rights of action against an employer;
2. the insurance principle of risk-spreading is made possible. By payment of a comparatively small assessment or premium, each firm avoids the risk of being responsible for its own accidents.

The workman is furnished with the following benefits:

1. prompt medical attention for injuries;
2. compensation to accident victims to at least partially supplant loss of earnings;
3. in the case of permanent impairment a percentage of disability pension based on medical evidence, in the case of death a pension to support the dependents of the workman.

The public generally is protected by workmen's compensation laws through:

1. cessation of the economic waste resulting from unnecessary trials;
2. elimination of the burden on public charities by poverty previously often caused by industrial mishaps.

Methods of Assessment

There are two methods of assessment which have been adopted by workmen's compensation agencies: namely, the occupational basis and the industrial basis.

The occupational basis is in use in many of the United States. Under this system the employees of a business must be classified by the nature of the work they perform, and each group of employees is assessed at a different rate on the payroll. This method avoids some of the apparent inequities of the industrial method but because of its complexity has the disadvantage of being more costly to operate.

All the Provinces of Canada have adopted the industrial basis of assessment. Industries of approximately the same nature and degree of hazard are grouped into classes, and every business falling in a given class is assessed at the same rate on all employees' earnings.

It often happens that a particular business has more employees in the non-hazardous occupations (such as office-workers) than the general average of businesses in that group or class. When this occurs, and a good accident experience appears to prove the unfairness of the classification, representations are sometimes made to have the business placed in a class by itself. To do so would destroy the mutual insurance principle on which the compensation structure is based, and introduce the principle of "self-insurance". It is obvious that any trend towards smaller classes results in more widely fluctuating compensation insurance rates from year to year. Furthermore, some of the most costly accidents can and do occur in the so-called non-hazardous occupations.

To endeavour to make employers more safety-conscious a system of merits and demerits has been adopted by some of the Boards. Under such a scheme, for a favourable accident experience the employer is rewarded by a refund of a percentage of the assessment charged him. Conversely, for a bad experience the employer is penalized by the charge of an additional assessment.

In setting the rates of assessment to be levied against a particular class, the Board must consider and weigh many factors, which include:

1. a predetermined estimate of the costs likely to be incurred by the class for the coming year, and the estimated assessable payroll against which the rate is to be used;
2. the solvency or insolvency of the class as measured by the accumulated surplus or deficit from previous years' operations;
3. the recent trend must be considered in the light of whether or not rates previously set have been excessive or inadequate to cover costs;
4. the size of the class must be regarded. In a small class where one accident can represent a large percentage of the total costs of that class, there is apt to be no trend or at least it will be more difficult to follow.

Investment Portfolio

Although the various provincial Acts do not specify any limitation on investments, it is implied, and sound administrative policy dictates, that no securities should appear in the portfolio which are more speculative than those allowed by law to be held by a trust company or an insurance company.

Security holdings of the Canadian Boards have been confined to:

1. Dominion of Canada bonds;
2. bonds guaranteed by the Dominion of Canada;
3. provincial bonds;
4. bonds guaranteed by the Provinces;
5. municipal debentures including school debentures.

Since short term investments create the necessity of frequently re-investing the funds of the Board, diversified issues with maturity dates 20 years or longer in the future are preferred. Careful consideration must be given to obtain the best possible yield without sacrificing security.

A Glance at Claims Administration

In the United States there is wide diversity in the method of handling claims. Administration by the Courts is known. In other States private insurance companies supervise all claims and make all settlements on the claimant. In still others, the state compensation agencies dispose of their own claims by direct settlement.

In Canada a uniform system of claims administration has been adopted. The provincial Boards superintend their own claims retaining personnel to examine and adjudicate each case received. When the necessary reports are in from the

workman, his employer, and the medical practitioner who is treating him, and the claim has been established as a valid one, payment of compensation to the workman should be made as promptly as possible. The claims and accounting functions of the Boards have in the past strived to eliminate all unnecessary "red tape" and to streamline their activities with a view to making a settlement (or partial settlement in the case of continuing disability) with a minimum of delay from the date of injury.

The Workmen's Compensation Acts being generally considered as social legislation, the attitude of claims officers should always be one of sympathetic approach to the problems of the disabled workman. Where reasonable doubt exists in the handling of a particular case, the bias should be in favour of the claimant. When it does become necessary to disallow a claim, it is important that the workman and his employer both have a complete knowledge of the reason for the rejection. A feeling of goodwill and respect for the Board can be built up if all contentious claims are handled in a careful and tactful manner.

Claims Pending and Unfinalled Claims

Each year an estimate must be made by administrative officials of the Board of the remaining cost on claims in various stages of completion but which have not reached finality, and the cost likely to be incurred on unreported accidents occurring at the year end.

The estimate is substantially based on previous experience. A study of relevant cost data covering a period of years shows that usually a trend can be followed for each of compensation, medical aid, and pension awards.

One method of computing the estimated liability is shown by a simple hypothetical case covering the compensation costs for a certain class "X" of industry:—

Admitted to the Alberta Institute in 1948, Mr. James P. French, C.A., was made assistant comptroller of the Alberta Workmen's Compensation Board and held that position for three years. In August 1951 he joined the construction firm of Brown and Root Limited as chief accountant for their Edmonton office.

Assume expected residual percentage of costs as shown by past experience to be:

At end of 1st year	80%
At end of 2nd year	25%
At end of 3rd year	15%
At end of 4th year	10%
At end of 5th year	5%

Assume compensation costs actually incurred for Class "X" to be:

In 1950 re 1950 accidents	$100,000
In 1949 re 1949 accidents	$ 75,000
In 1950 re 1949 accidents	35,000
	$110,000
In 1948 re 1948 accidents	$ 68,000
In 1949 re 1948 accidents	34,000
In 1950 re 1948 accidents	13,000
	$115,000
In 1947 re 1947 accidents	$ 60,000
In 1948 re 1947 accidents	30,000
In 1949 re 1947 accidents	10,250
In 1950 re 1947 accidents	5,000
	$105,250
In 1946 re 1946 accidents	$ 50,000
In 1947 re 1946 accidents	27,500
In 1948 re 1946 accidents	9,000
In 1949 re 1946 accidents	5,000
In 1950 re 1946 accidents	3,000
	$94,500

80% on costs after 1st yr	$100,000	$80,000
25% on costs after 2nd yr	110,000	27,500
15% on costs after 3rd yr	115,000	17,250
10% on costs after 4th yr	105,250	10,525
5% on costs after 5th yr	94,500	4,725
		$140,000

The outstanding liability for compensation payments in Class "X" at December 31, 1950 is thus estimated at $140,000. A similar computation is used on the other classes of industry to arrive at the total estimated compensation liability. Applying the same procedure to medical aid and pension award costs, a figure of total claims liability is acquired for balance sheet purposes.

The estimated pension liability as computed in the above-described manner can be adjusted to greater accuracy by considering it simultaneously with the known pension liability. At the end of the year there are numerous claim files in process on which there will be permanent disability pension awards. These are listed and the amounts of the expected awards extended and totalled by classes. These totals are then adjusted by a fixed percentage as an allowance to cover estimated pension costs on unreported claims. By averaging the potential liability for outstanding pensions deduced in this manner with the first method shown, obvious errors in estimate can often be corrected.

It should be borne in mind that the provision for claims pending being a charge against the revenue account, the amount by which the estimate proves to be excessive or deficient must be adjusted on revenue account in succeeding periods.

Reserve for Disasters

Included in the assessment rate is a charge or levy on each employer as a contribution to the reserve for disasters. This is a fund set up to meet the unusually heavy expenditures of any accident which is deemed by the Board to be a "disaster". A criterion is established, and costs in excess of the set figure chargeable against one class, caused by one happening, are debited to the reserve account. By following this procedure no single accident will unduly burden the employers in any class of industry. The disaster reserve provides a cushioning effect on the results of a serious mishap to the class balance. It also has a definite stabilizing effect on the fluctuation of class assessment rates.

Adequacy of Benefits

During his period of incapacity, the worker and his family will either maintain a decent standard of living or suffer hardship, depending on the sufficiency of the benefits provided under the Act.

Prompt medical attention and hospitalization, if required, are furnished to the workman, all of which are paid entirely by the Board.

The compensation for loss of wages is not equal to the workman's earnings for several reasons. So that the irresponsible employee will not use every minor injury as an excuse to remain off work, the Boards have retained the "waiting-period" (usually 3 days). This is a necessary rule which works no particular financial hardship. On periods of longer disability, the payment of compensation is made retroactive to the date of injury.

Proposals have on occasion been made to adopt a 100% compensation scale. Such a situation is exceptional even with prosperous industry which could pay on such a high standard. In almost all jurisdictions the range is from 50% to 75% of average earnings. Were it as attractive financially to remain on compensation as work, many cases of malingering and intentional exposure to unnecessary hazards would result.

For the permanent disability of a workman, a pension is paid, based on the

percentage of remaining disability as established by medical evidence. Because most pensioners are unaccustomed to handling sizeable sums of money, most jurisdictions consider unwise the commuting of pensions and making lump-sum settlements even for stated sound purposes.

In case of death of a married workman through injury, a set amount of pension is paid his widow for life or until re-marriage, and a monthly payment is made for the care of each child until a self-supporting age is reached. In recent years the widows' pensions have been increased periodically by the Provinces. As the principle of retroaction does not apply to new workmen's compensation legislation, some of the early pensioners have been finding themselves in indigent circumstances due largely to the recent inflationary trend and shrinking dollar values. Certain legislatures have already recognized this apparent inequity and have recapitalized earlier pensions placing all widows on an equal benefit basis.

Industrial Diseases

An industrial disease might be defined as any disease contracted by a workman in the course of, and caused by, his employment, resulting in the disablement or death of the workman. In the administration of claims, the occurrence of industrial disease is treated the same as the happening of any accident resulting in personal injury.

The commonest of industrial diseases in Canada is silicosis — a fibrotic condition of the lungs brought on by dust containing silica. It is mostly in the mining, stone-cutting, and quarrying industries that silica dust is encountered. This fact does not, however, automatically rule every other employment as wholly free from the risk of developing the condition. Since silicosis is usually caused only by prolonged exposure, the question arises as to which employer's account should be charged with the costs of treating a workman so incapacitated. Labour being of a transient nature, one man may work for several employers even in different classes of industry, where the silicotic condition could be acquired. In many instances it would be a wrong procedure to charge the whole cost of the claim to the employer for whom the man was working when the disabling symptoms became evident. To endeavour to review the man's employment record over a period of years, and prorate the claims costs over several employers, does not appear to be a satisfactory solution.

The difficulty has been overcome by each employer paying into a silicosis fund. In setting the rate of assessment for each class, a provision is made to cover the estimated cost of paying silicosis claims in that class. The costs of the claims which do arise are charged against the reserve.

Additional Services

It is more desirable to prevent accidents than to try to pay for them after they have happened. As the assessment rate must vary proportionately with the total accident costs, the conscientious accident prevention department performs a valuable service to industry through its efforts to reduce the number of accidents. This is done by:

1. studying the various causes of accidents and taking steps to avoid recurrences;
2. periodic inspection of employers' premises for hazardous features;
3. educating workmen in safe practices through the circulation of safety literature and posters, the presenting of lectures and safety films by Board personnel, and the organization of safety committees within the larger industries.

A few years ago very little was done, because of lack of funds and lack of suf-

ficient interest in the workmen's welfare, to restore the physically handicapped to useful employment. There is now, however, a broadening scope of service which Compensation Board administrators are successfully performing. Many injured workmen find that they cannot return to their previous work, presenting the various Boards with a problem of rehabilitation and retraining. Physiotherapy treatment, which reduces the degree of permanent disability and hastens recovery, is an important part of any rehabilitation program.

The mental factor is important as idleness tends to stimulate the idea of hopelessness. Vocational training under the guidance of men specializing in this field develops new skills enabling the return to useful occupations. These injured men themselves can do much by proving that they are not more accident-prone than other workers, and by developing a good record as to production, attendance, and loyalty to the firms employing them.

Conclusion

The wide range of compensation laws on the continent makes it possible for alert compensation administrators to judge their own performance by what others are doing. No matter how well a job is being done there may be some way to do it a little better. It is only by constant self-criticism, followed by the introduction of newer and improved practices to replace obsolete ones, that real progress is attained.

THE INTERNATIONAL CONGRESS ON ACCOUNTING, 1952

THE Council of The Sixth International Congress on Accounting, 1952, at a meeting on September 26, 1951, appointed Sir Harold Gibson Howitt, G.B.E., D.S.O., M.C., F.C.A., a past president of The Institute of Chartered Accountants in England and Wales, to be president of the congress to be held in London in June, 1952.

Mr. Charles Percival Barrowcliff, F.S.A.A., president of The Society of Incorporated Accountants and Auditors, has been appointed vice-president of the congress.

The program for the congress will be found on page 48 of the August issue of *The Canadian Chartered Accountant.*

The Provisions of the Dominion Succession Duty Act

By T. B. Nash

A concise but comprehensive summary

THE Dominion Succession Duty Act, which is the only Act which I propose dealing with in this article, came into effect on June 14, 1941, and while the Provinces of Ontario and Quebec still levy succession duties, residents of British Columbia are primarily concerned with the Dominion Act. At the time the Dominion Government entered into arrangements with all of the Provinces except the two mentioned above, it doubled their rates of duty, but in order not to create hardship for those beneficiaries required to pay duties to the Provinces of Ontario and/or Quebec, an allowance was provided for of the lesser of (a) the duties payable to any Province and (b) 50% of the Dominion duties.

Reciprocal agreements are also in effect with the United Kingdom and Northern Ireland, the United States of America and New Zealand, for the avoidance of double taxation, and very recently reciprocal arrangements have also been entered into with France. Under these agreements, certain allowances are provided for to prevent duplication, but in the case of the United States of America it must be noted that the individual States, some of which levy inheritance taxes, are not parties to the agreement.

Two Basic Principles of Taxation

There are two basic principles of taxation with respect to estate property passing at death: an estate tax upon the right to give and an inheritance tax upon the right to receive. The Dominion Act incorporates both of these principles by having an estate tax known as an "initial rate" based on the net value of the estate, and an inheritance tax known as an "additional rate" based on the amount a particular beneficiary receives and his or her relationship to the decedent. The basic rates increase in proportion to the size of the estate and the additional rates in proportion to the size of the legacy and as his or her blood relationship decreases. For example, in an estate of $60,000 the basic rate is 3.3% and in an estate of $600,000 it is 11.3%. A legacy of $10,000 passing to a child of 18 years or over is taxed at 4.8%, whereas a legacy of $60,000 passing to a stranger in blood is taxed at a 12.6% rate.

Incidence

Succession duties are levied as follows:

(a) If deceased died domiciled in Canada, on all real property situate in

An address to the Institute of Chartered Accountants of British Columbia, June, 1951

Canada and all personal property wherever situate.

(b) If deceased died domiciled outside of Canada, on all property situate in Canada.

The word property referred to above covers, for the purpose of the Act, practically every conceivable form of estate or interest and includes the following:

(a) personal effects, furniture, automobiles;
(b) stocks, bonds, cash;
(c) mortgages, agreements for sale, promissory notes, "i.o.u."s, etc.;
(d) interest in a business;
(e) life insurance owned by the decedent whether payable to the estate or a named beneficiary;
(f) property held in joint tenancy, such as bank accounts, home, etc., to the extent the decedent contributed;
(g) gifts within three years of death (if gift tax has been paid the amount so paid may be deducted);
(h) gifts in contemplation of death;
(i) annuities, superannuations, pensions, etc.;
(j) any property which the deceased was competent to dispose of.

Exemptions

The main exemptions allowed are:

(a) all legacies of $1,000 or less;
(b) gifts to the Crown;
(c) gifts to recognized charitable organizations;
(d) $20,000 where the widow is the beneficiary, plus $5,000 for each child under 18, if such child does not benefit (if child does benefit $5,000 less the amount of the benefit);
(e) $5,000 where child under 18 is beneficiary;
(f) $15,000 where child is orphan under 18;
(g) gifts made at any time which can be considered part of ordinary and normal expenditure;
(h) absolute gifts made over 3 years before death.

Estates of $50,000 or less are not subject to duty.

"Quick Successions"

An allowance is also made in the cases of what are known as "quick successions". For example, assume that a husband dies leaving certain property to his wife, who in turn dies shortly after leaving the same property to her children. The allowances based on the same property, or substitutions therefor, passing to the wife and then to the children are as follows: if second death occurs within one year, property is valued at 50%; 2 years, 60%; 3 years, 70%; 4 years, 80%; 5 years, 90%; over 5 years, 100%.

Payment of Duties

Unless otherwise provided, these are payable within six months from the date of death, and after that are then subject to interest at the rate of 5%. The Minister is empowered in *extreme* cases to postpone the payment of duties and to lessen the rate of interest if he feels the circumstances warrant such action. The duties on life interests and annuities are payable in four equal annual instalments, the first of which is payable one year after the date of death. Duties on remainder interests may be paid within six months of date of death or within three months of the time when they fall into possession. If paid at the latter time, it is on a basis of the fair market value at the time of the falling in and no deductions are made for the duties already paid on the life interests.

An Illustration

The foregoing covers in a very sketchy way the main provisions of the Act, and I now propose to apply some of these provisions to a particular theoretical case, as follows:

Let us assume that John Brown, president of XY Company Limited, has decided to consult us regarding the planning of his will and after a preliminary discussion we ascertain that he has a wife, aged 53, two sons, aged 28 and 24, and a widowed daughter, aged 26, who has a very young son. We take his statement of affairs which, in this case, is shown in the memorandum on p. 247, and our next step is to discuss with him as to how he wishes to leave his estate. Having learned that, we consider now how this will work out succession-duty wise, both as to the amount of duty payable and when it is payable, and also the question of income tax in the hands of the beneficiaries must also be considered. Our approach to this problem might be somewhat along these lines:—

If he left his whole estate of $317,375 to his wife outright the duties would be $81,183 all of which would be payable within six months of the date of his death. If his wife died five years later, leaving an estate of, say, $210,000 to the three children equally, the duties payable within six months of her death would be an additional $36,540 so that total duties paid would be $117,723.

In the planning of a man's will, it is my own thought that where the estate will be reasonably substantial he should first of all provide his wife with a home to live in for the rest of her days, give her the furniture and car where it is applicable, provide her with a legacy to give her a certain amount of reserve, and then let her have the life use of the estate with power to the executors to use such amounts of capital as may be necessary for her comfort and support, and then to leave that part of the estate not used by the widow direct to the children on her death. There are many variations of this, of course, but in many cases this might well apply.

Therefore, if Mr. Brown left his wife his home, the furniture, car, a legacy or insurance of $10,000, and the income from the balance of the estate for life with power to use capital with the remainder on her death going direct to the children, there is only one "passing" of the assets of the estate of Mr. Brown and succession duties are payable only once. Total succession duties based on this method are $62,095 of which approximately $6,170 is payable within six months of his death; approximately $33,590 can be paid over a period of four years and the balance can either be paid in six months after his death or, if necessary, on the death of the widow. Let us assume in this case that the duties latterly mentioned are paid on his death with the result that the net saving in succession duties as against the first method mentioned is $55,628.

As the rates on the property passing to individual beneficiaries vary, the duties are lowest when all rates are the same. In this case we ascertain that the rate on the widow's interest is 24.3% on $163,617 and the rate on the children's interest is 16.7% on $44,586. It is obvious therefore that a further saving in duties is possible by keeping down the share passing to the wife and increasing the children's shares. With this in mind, therefore, Mr. Brown decided to give her the home, furniture, car, and legacy as previously outlined, but only to give her ¾ of the income for life and the remaining ¼ to his widowed daughter as long as his widow lived. The execu-

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Mr. T. B. Nash joined the National Trust Company in 1931 and is now trust officer for the Vancouver Branch of that company. Long interested in the Army, he is presently Lieutenant-Colonel commanding the B.C. Regiment (Res.)

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tor, of course, can still encroach on the capital for the benefit of his widow. He also leaves a legacy of $10,000 payable on his death to each of his children and with these changes and the remainder still divided equally among the children, the duties work out to $58,139 being a further saving of $3,956 and of the amount of $58,139 approximately $10,600 is payable within 6 months; $26,000 is payable over four years and the balance may be paid either in six months or on the death of the widow.

By further application of the principle of equalizing the rates applicable to each beneficiary, a further saving of duties is still possible, but we have now arrived at the point where any further saving in succession duties results in a division of the estate which is not in accordance with Mr. Brown's wishes.

The Income Tax

The question of income tax may be briefly discussed here as there has been some saving made by giving his wife only ¾ of the income rather than the whole and there will now be two people paying income tax on the income of the estate rather than one. Further reductions in income tax might have been possible by giving each of the beneficiaries ¼ of the income during the life of the widow, but again this did not conform to Mr. Brown's wishes. This, can, of course, be done and thus spread the income tax load around.

Liquidity

The next question to consider is liquidity.

Let us assume that funds will be required for the following:—

(a) expenses of last illness;
(b) burial;
(c) debts;
(d) legacies of $30,000;
(e) succession duties (payable within six months if commuted).

All of the above might total		$70,875
Mr. Brown now has the following liquid assets:		
Bonds	$10,000	
Stocks	6,875	
Cash	4,000	20,875
He therefore needs additional liquid assets of		$50,000

Where to Find Money

The next question is to decide where this is going to come from. He might possibly, with the approval of his wife, use the insurance policy as part of the $50,000 but this would not appear practicable as he wishes to leave her a cash legacy of some sort. He might also consider the sale of his real property, but in this case it would not appear proper as his business is situate on it and he would naturally not like to have an outsider become the owner. If insurable he could take care of this situation by buying more insurance. If none of the above applies, about the only alternative he has is to consider taking out the surplus from his business under section 95A of the *Income Tax Act,* and in this particular case, let us assume he has decided on the latter course, providing, of course, that after consultation with his auditors they so approve. If this method were adopted then his estate would be reduced by 6/10 of $45,000, which is his interest in the tax paid, and the duties would be correspondingly lower.

Valuation of Assets

Let us assume at this stage that Mr. Brown executed his will as we have outlined it for him, and he died without having done anything about his affairs and that the estate is still $317,375. I would like now to discuss with you the question of how the Department would value his various assets for succession duty purposes, bearing in mind the fact

that the Act states that the value is based on fair market value at the date of death, which value shall be arrived at by the Minister in such manner and by such means as he shall see fit. Let us take each asset in detail.

Real Estate: this is normally done by an independent qualified appraiser.

Furniture: in the average home the Department will generally accept the valuation of the trust company, but in cases where there are such things as antiques and the furniture is of a more expensive nature, then it is normal that an independent qualified appraiser be called in.

Automobile: this is normally done by an independent appraiser.

Stocks and bonds: the Department generally takes the last sale on the day of the date of death and if there were no sales on that day, then they take the bid price.

Loan to brother: the question to consider here is: is it collectible, whether statute barred or not? If it is, then it must be shown at its proper value.

Interest in business: the Department uses two methods of valuing an interest in a business; namely, book value and earnings, and are inclined to lean towards the latter method. It is my understanding from the Department here that if the late Mr. Brown had gone so far as to show an intention of electing under section 95A of the *Income Tax Act* that they will tax on the assumption that he has and that, therefore, an allowance of 15% would be made. It is also my understanding that in the case of minority interest or where the head of the business no longer is alive, that allowance will be considered but that in all of these cases each is treated on its individual merits and is the subject of negotiation with the Department.

With regard to the valuation of the business on an earnings basis, the Department makes semi-annual surveys of corporation earnings as published and ascertains from these figures and the prices at which the shares are trading a capitalization rate and on the basis of these figures they are at present capitalizing on a basis of eight to ten times earnings ,so that if a share is earning a dollar a year, the value of that share would be between eight to ten dollars. They also like to have earnings statements of the company for as many years back as is possible and lean to the view that the figures for the last five years are the proper figures to use. They will probably work out the value of the shares on both bases and somewhere between the two they may make their assessment.

Transfer of Securities

The last question I wish to outline briefly is that of the usual requirements of a transfer agent to transfer registered bonds and stocks from the name of a decedent into that of the executor so that they may be dealt with. For this purpose I am dividing corporations into three groups:—

1. those who have head offices in the Provinces of Ontario or Quebec and whose shares can only be transferred in those Provinces;
2. those who have head offices in the Provinces of Ontario or Quebec but whose shares can be transferred there and in other Provinces as well;
3. those who have head offices elsewhere than in the Provinces of Ontario or Quebec.

As previously stated the Provinces of Ontario and Quebec still levy succession duties and it has been established that these Provinces have jurisdiction over those corporations having head offices situated there. The consequence of this is that in the case of those corporations the transfer agent is required to obtain a succession duty release from whatever Province is applicable before transmitting shares of a decedent.

You will notice that in the assets of John Brown, I have included several representative stocks, and if you will refer to them you will notice that Ford Motor Company of Canada Limited and Canadian Pacific Railway fall into Group 1. In these cases the executor must obtain a release from either Province and while the total of the decedent's holdings in each Province will decide which one, normally it would be where the head office is located. In any case, if duties are paid to one Province the other will not duplicate them and will issue a release without charge upon receipt of the proper returns. The next stock shown is that of British American Oil Company Limited which has a head office in the Province of Ontario but is one of those corporations in Group 2 whose shares may be transferred also in Manitoba and British Columbia. In this case the executor must make all the necessary returns to the Province of Ontario and obtain a release. However, as the stock can be effectively transferred outside of Ontario the release is obtained without payment of any duties.

Van Roi Consolidated Mines Limited falls into Group 3 as its head office is situated in the Province of British Columbia. Obviously the Provinces of Ontario and Quebec have no jurisdiction and no release is required from either. In this case, however, as it is a company incorporated in the Province of British Columbia a release is required from the Province under the *Probate Fees Act.*

As the Province of British Columbia has jurisdiction over all the property of a decedent domiciled there, releases are required on all assets, but in some cases outside transfer agents will not insist upon them.

The two American companies have been included to bring out the facts that if the American assets of a decedent do not exceed the sum of $2,000 a release from the federal government is not required, and that in the case of the State of New York inheritance tax is not levied. The State of Michigan, however, does levy an inheritance tax.

Shares in Saudi-Arabian Oil Company have been included to show that in the case of some foreign corporations letters probate must be resealed in a foreign country before transmission can be effected and where the holdings are small it is possible that the cost of resealing might exceed the value of the shares.

The Dominion Government, as stated, levies succession duties on all property in Canada and personal property wherever situated so that in all the examples listed above the Dominion release will be required.

The requirements of a transfer agent involve the question of jurisdiction and situs, both of which are complete subjects within themselves and I have, therefore, attempted to touch only on the highlights. In fact this would apply in the case of all my remarks which were not intended in any way to be a complete coverage of the Act and the many cases pertaining thereto.

JOHN BROWN

ASSETS

At Date of Interview and also at Date of Death

Cash		$ 4,000.00
Home in joint tenancy more than 3 years—½		10,000.00
Furniture and effects		5,000.00
Car		3,500.00
Bonds, Dominion of Canada and Provincial		10,000.00
Stocks:		
25 Shares Ford Motor, @ 52.00	$1,300.00	
H. O. Windsor		
T. A. Canada Trust, Toronto		
Montreal Trust, Montreal		
50 Shares C. P. R., @ 26.00	1,300.00	
H. O. Montreal		
T. A. Royal Trust, Montreal & Toronto		
25 Shares B.A. Oil @31.00	775.00	
H. O. Toronto		
T. A. Chartered Trust, Toronto & Montreal		
National Trust, Winnipeg & Vancouver		
1000 Shares Van Roi Consolidated Mines Ltd., @ $0.65	650.00	
H. O. Vancouver		
T. A. National Trust, Vancouver		
10 Shares Chase National Bank @ $250.00	2,500.00	
H. O. New York		
T. A. New York		
25 Shares Rio Motors Inc., @ 13.00	325.00	
H. O. Michigan		
T. A. Michigan		
25 Shares Saudi-Arabian @ $1.00	25.00	
H. O. Bahamas		6,875.00
Life insurance—payable to wife		10,000.00
Real estate—business property		25,000.00
Loan to brother		1,000.00
Gift to son within three years		2,000.00
Controlling interest in XY Company		
Capital $100,000.00—Brown 600 x 100		
Associate 200 x 100		
Employees 200 x 100		
Surplus $300,000.00		240,000.00
Total assets		$317,375.00

Assume liabilities nil.

JOHN BROWN

Estimate of Succession Duties

Estate - $317,375.00

Wife (age 53)			
½ interest in home	$ 10,000.00		
Furniture and effects	5,000.00		
Car	3,500.00		
Legacy or life insurance	10,000.00		
¾ of life interest in balance of $258,875.00	104,256.00		
	132,756.00		
	20,000.00		
	$112,756.00	21.7%	$ 24,468.00
Daughter—over 18			
¼ life interest (for life of mother) in balance of $258,875.00	$ 34,752.00		
Legacy	10,000.00		
1/3 remainder	39,956.00		
	$ 84,708.00	19.7%	$ 16,687.00
Son—over 18			
Legacy	10,000.00		
1/3 remainder	39,956.00		
	$ 49,956.00	17.0%	$ 8,492.00
Son—over 18			
Legacy	10,000.00		
1/3 residue	39,956.00		
	$ 49,956.00	17.0%	$ 8,492.00
	$317,375.00		$ 58,139.00
Payable in six months		10,623.00	
Payable in four years		26,061.00	
May be postponed		21,455.00	
		$58,139.00	

ECONOMISTS AND ACCOUNTANTS

SOME six years ago The Institute of Chartered Accountants and The National Institute of Economic and Social Research, impressed by the need for a "closer understanding between accountants and economists regarding the principles applied in their respective fields of work", appointed a joint committee to further this good work. And now the report of the committee is published under the title *Some Accounting Terms and Concepts* (Cambridge University Press, 46 pages, 3s. net). We confess, with reluctance and with respect for the distinguished authors of both Institutes, that we read this booklet with disappointment that mounted from page one to page 46. Six years of consultations seem to have brought forth little more, beyond a useful discussion of accounting procedures, than the negative conclusion that never will either side be persuaded that it is other than a Stokes confronted with a Mossadiq.

For ourselves, we do not believe that the twin disciplines of accountancy and economics need stand so far apart — and we feel that the pressure of events will force them to draw closer together. Examining the numerous differences between them that are set out in the booklet, only two need be regarded as really important: the others are but marginal, and would soon disappear if the central differences were resolved. The one important difference is over the measurement of stock usage during the accounting period, the other is over the measurement of the consumption, during the period, of fixed assets. It is explained that economists, concerned with the maintenance of physical assets, would not strike the figure for the operating profit of a business before deducting from operating incomings sufficient to allow for both stock and fixed assets to be kept, in a physical sense, as they were at the beginning of the period. On the other hand, the accountants' criterion is described as the maintenance of the money capital of the proprietors, so that the deductions from operating incomings need suffice only to keep intact the money value of the stock and fixed assets.

In this accounting day and economic age, what we are here given is a rather bald statement of the differences of view. It is one which needs to be followed by a closely reasoned discussion of what feasible modifications to the "principles" of both economists and accountants would be necessary for a *modus vivendi.* The report contains no discussion of this kind, does not even give arguments why neither side can make departures from the stand it is described as taking. If either economics or accountancy were founded upon rigid "principles" from which it would be sacrilegious to suggest any deviation, then, indeed, all that could be said is "Here is white — and there is black." But neither economics nor accountancy is divinely inspired. Both are pragmatic studies, to be fashioned by men in the service of men. Each can take on varying hues of greyness.

As an instance of what we have in mind, consider the economists' idea that fixed assets should be maintained intact

An editorial in September 8 *Accountancy,* the monthly journal of the Society of Incorporated Accountants and Auditors, published in London.

in a physical sense. If this idea is carefully examined, it is seen to be neither precise nor quantitatively definable. And if it is not, then no economist can insist that depreciation should be just so much of replacement cost — can contend, Portia-like, that it should be not "more or less than a just pound". Again, in an incidental remark, the report itself says that what economists aim at maintaining intact is the "productive capacity of an enterprise". But, clearly, in a dynamic economy this is by no means the same thing as restoring the fixed assets to their original physical condition. There is scope for judgment in deciding how much money is needed to preserve productive capacity, and the figure finally hit upon need be only very remotely related to replacement cost. Or, again, it is argued by economists that the replacement cost basis of depreciation should be admitted for taxation purposes. But even if it were so admitted, what economist could conscientiously expect them to admit as an expense any part of a depreciation quota so calculated which, at the conclusion and in the end (as the Mexicans say), was not in fact turned into fixed assets in the business?

We think that on the side of accountants also there is a greater willingness to modify traditional procedures than is admitted in the report — or, at least, that there would be a greater willingness, if the case were properly argued. As an example, take the treatment of "inventory profit". The report allows, in a pregnant but tantalizingly laconic reference, that some methods of calculation of stock usage — "first-in, last-out," base stock — alternative to the most usual one, go part-way in applying the economists' principle of replacement cost. But they are described as "merely differences of method which do not affect the principles already outlined. Is this so? These alternative ways of computing stock usage might appropriately be regarded as aimed at achieving a profit figure considered to be more correct. Again, we suspect that there are many accountants who would be willing to follow Mr. Bertram Nelson in his suggestion (see *Accountancy* for August, p. 297-8) that after providing for depreciation on historical cost, there should be an additional setting aside of operating incomings before computing distributable profit (perhaps in a separate account) and that this additional setting aside should be calculated upon lines which would be recommended for general adoption in the accountancy profession. The report could have given some guidance on what such lines might be, even without accepting the suggestion itself or one like it — but on this, as on so many other significant issues, it is silent.

Financial Statements For the Smaller Company

By R. W. Hamilton, B.Com., C.A.

The smaller incorporated business is the backbone of public auditing practice

PROGRESS in our profession requires that we should examine periodically if not continuously the nature of our response to the expanding needs of business in general as represented in the particular by the affairs of individual clients. My purpose here is to consider the adequacy of the present-day conventional year-end financial statements as related to the needs of smaller incorporated businesses, which after all comprise the backbone of public practice in many parts of Canada.

Advances by Large Companies

Significant advances have been made and are being made in the form and content of published statements of larger public companies. Directors, with the passive acceptance, or active assistance, of the shareholders' auditor, are bringing into their confidence not only the individual shareholder but labour and the general public as well. Terminology is being standardized and language simplified. Relationships and comparisons are being presented in graphic or pictorial form as more readily and easily comprehended. The whole presentation is being dressed up in eye-pleasing manner to make an interesting and readable commentary, as compared with the dreary report of just a few years ago. In addition, presidential addresses and directors' reports are carefully integrated with the financial statements to give the reader a well-rounded picture of affairs. These improvements and embellishments are, however, expensive and, therefore, beyond the practical means of many.

Little if anything has been done to improve the annual statement of smaller companies whose needs, though quite different in nature, are still in a large measure inadequately met. This is so despite the fact that for every public company in Canada there are ten private companies, and despite the fact that for every company reporting taxable income over $100,000, there are ten reporting under $100,000.

It would be a mistake to assume that the techniques developed for the larger public companies can be applied in any material degree to smaller enterprises. Their needs are quite different,

An address to the 49th annual meeting of the C.I.C.A., Banff, Sept. 4, 1951

but in the aggregate of equivalent importance.

The Auditor's Responsibility

It is moreover of significance to us here that in the vast majority of cases the content and form of the annual statement is, by accepted custom, the peculiar responsibility of the auditor who certifies the statements he has himself prepared. The language used is *his* language, the calculations presented are *his* calculations, the facts commented upon are those he chooses to comment on: the whole presentation is his from end to end. It is idle to say that by law the statement is the company's and that the auditor merely certifies it: the plain fact is, as we all know, that whereas it deals with the company's affairs, it is nevertheless the auditor's statement as to those affairs.

In the typical smaller company, ownership and management are closely associated, if not identical, and relationships with employees, customers, and suppliers are on a more personal basis. On the other hand the owner-manager lacks broad financial training and experience, although he knows much about the detailed operation of the enterprise; he makes decisions on the basis of practical judgment without assistance or hindrance from budgets and forecasts, which he can neither afford nor understand. His internal accounting staff know nothing of the mysteries of income tax and little more of the legal formalities peculiar to the corporate form of organization. He does have, however, a public accountant of whom it is said "He looks after our books", or "He makes up our tax returns", or more generally, if less truthfully, "He looks after us".

The owner-manager knows that it is customary, and legally necessary, to prepare a financial statement at least once a year; he knows, too, a statement must be prepared to be filed with income tax returns. This statement the public accountant will prepare for him (thank Heavens!) and provided it doesn't cost too much, and provided that it shows a high net in poor times and a low net in good times, his basic requirements are met.

With experience, he becomes familiar with the general format of the income statement, the surplus statement, the balance sheet, and the rigmarole of the auditor's certificate. Frequently he expects little more and gets little more, getting, in fact, something less than his money's worth, for the reason that a great deal of the work entailed in the examination of accounts represents service *performed* but not service *delivered*. By the time the audit is completed, the working papers include a wealth of information that frequently stagnates there, information that may be of value to manager, owner or banker.

Ignorance of Income Taxes

Some examples of what I have in mind may be of interest.

Take the matter of tax provision. In these days of changing rates and brackets, only persons dealing with tax from day to day know or can remember the detailed rates, or indeed even such general principles as prorating income in split periods. True, a study of the completed tax returns would furnish the pertinent information, but the printed forms are changing in setup from year to year, and are designed to fit the general rather than the particular case. In some instances, therefore, it might be expedient to prepare a schedule for inclusion with the usual statements, showing, first, the relationship of corporate net income to taxable net income, and, second, the actual

computation of the tax in a simple form appropriate to the circumstances.

How many corporate clients fail to realize that a $100 dividend is worth more than $100 in interest income? How many understand the backward-forward loss rule, the effect of withholding depreciation, the recapture depreciation provisions, all of which as well as many other tax provisions have a substantial bearing on current and aggregate tax cost? How many clients understand the implications of tax rate changes occurring within the fiscal period or the effect of the $10,000 income notch?

A simple presentation of the kind I mention will do a great deal toward educating our tax-paying clients as to the broader aspects of tax, thereby requiring less of our time to *get* them out of trouble, and leaving us more time for *keeping* them out of trouble.

Come now to the question of tax liability. Frequently we make no refererence to the terms of payment of tax liability in statements, beyond showing it as a current item, and content ourselves with a phone call to the bookkeeper or an oral explanation to the directors. And yet the terms of payment may be vital. How much is in arrears? Are we actually ahead or behind in tax payments? How should the schedule of monthly payments be revised? What years have been assessed? These are natural and obvious questions which can be simply answered by the procedure suggested.

A member of both the Alberta and B.C. Institutes, Mr. R. W. Hamilton, B.Com., C.A., has combined his practice of the profession in the firm of Winspear, Hamilton, Anderson & Company with leadership in the public and university life of Edmonton. For 13 years he was an instructor in the Department of Accounting of the University of Alberta and at present he is chairman of the University's Hospital Board. He has also served as alderman for the city and as president of the Edmonton Club. In 1946-47 he was president of the Alberta Institute.

Inadequacy of the Profit and Loss Statement

With regard to the profit and loss account generally, the conventional treatment leaves much to be desired, and in a great many cases additional information, available for presentation, is withheld for no particular reason. Frequently, for example, the owner-manager's salary is buried in a salary or wage total for no reason other than habit, and yet, as we know, this figure may vary materially from year to year for technical reasons, and comparisons of income from year to year are distorted if this factor is not separately shown. Frequently sales and gross profits, if not expenses, can, with little effort, be broken down by products or departments, rendering comparisons by years more informative. Often too, figures as to physical volume of sales and production are available, permitting more valid comparisons, particularly in these times of changing price levels.

My impression is that accountants generally are tending to present the income statement on a comparative basis showing last year's figures alongside this year's figures, but in doing so, seemingly imply that last year's results were normal, and this year's figures are variations from normal. Perhaps to submit the comparative data in condensed form, but for several years back would be more informative. Additionally or alternative-

ly, assistance might be given toward the interpretation of the data, by the presentation of a simple statement accounting for the variation in income, a statement which is easy to understand, readily prepared, but seldom used.

The Formalized Surplus Account

Turning now to the surplus account, it seems to me that in its present conventional form, it constitutes little more than an arithmetic proof, showing that net worth computed on an historical method commencing with last year, checks with the surplus computed on an inventory or balance sheet method. Perhaps this criticism is an an oversimplification. The fact remains, however, that with a little ingenuity, the surplus statement can be expanded to give additional valuable information. Part IA of the *Income Tax Act* has brought into sharp relief the desirability of emphasizing the complexion of surplus from a tax point of view, and I have seen many ingenious devices for showing the shareholder the status of surplus from that aspect. Considerable study has also been given to the analysis of surplus from the point of view of origin, distributability, and so on, and no doubt some advancement in everyday presentation for all companies large and small has thereby resulted. The emphasis, however, apart from the feature of arithmetical check to which I have referred, appears to be upon the *closing* balance of surplus, without any regard to the rate of growth, or historical aspects other than for the year directly under review. To present a history of the surplus from incorporation to date, either in detailed or condensed form, is usually the work of minutes: I say "usually" because, in Alberta for example, about half our active companies are less than ten years old and I would assume in the majority of cases the present auditor has complete files since inception of operations. Such a statement gives a clear picture of average annual profits, rate of growth, and degree of fluctuation, as well as the effect of dividends and extraordinary charges and credits. I will always remember examining the accounts of a company which showed profits every year without exception, never paid a dividend, and yet showed an operating deficit due to the particular treatment of charges applicable to prior years. Because of its limitation to a single year, the surplus statement of that company for any one year gave the completely erroneous impression that a cumulative loss position had finally been overcome.

While speaking of the historical aspect of surplus, a special circumstance frequently arises in that the shares of the company are acquired from one person or group by another. In future years the new owner is not interested so much in the total balance of surplus; he wants to know, to speak loosely, how much surplus he bought, and how much surplus he subsequently earned. Even a footnote to the conventional one-year surplus statement would go far to fill this gap in reporting.

Over-generalized Balance Sheets

Turning now to the balance sheet, my impression is that the chief inadequacy of smaller company statements is the lack of detail. In the case of larger companies, generalization in published accounts is necessary, firstly to compress masses of facts into comprehensible form, and secondly to preserve an appropriate degree of privacy as to internal affairs. This tendency to generalization frequently is apparent in statements of smaller companies even when neither justification obtains. In the first place the financial position to

be reported on is simple by comparison, and in the second place the need for secrecy is rarely present. In other words, the balance sheets of our leading industrial companies, no matter how excellently prepared, are in *no* sense, appropriate models for the average smaller company. Why should the company's banker, the mortgage holder, the unpaid vendor, its subsidiary or associated companies remain forever clothed in anonymity? Why should the amounts owing to three directors be lumped into one figure? In this latter connection I think perhaps we are prone to forget that shareholders are often as much concerned in their respective positions in relation to the whole as they are in the position of the company, and would be interested in a breakdown of such composite balances and even of shareholdings, with a view to answering a perfectly natural question "How much of this is mine?"

We could go on indefinitely to list questions, appropriate in individual cases, which could be anticipated and answered in the statements or by attachments thereto, at little additional cost. For the management of big business, the answers to such questions lie at the other end of a buzzer system, but not so in the smaller business.

Excessive Standardization

I do not suggest that the statements presented for smaller business are always limited to the trinity of income, surplus, and balance sheet. Indeed I gather that various offices pride themselves on certain supplementary statements such as lists of receivables and payables, application of funds, and so on, which they tend to include or attach, largely out of habit, irrespective of their merits in the instant case. Thus you find lists of receivables and payables laboriously prepared and presented, although every single account has been paid before the reporting date; in other cases where the lists of debtors and creditors, aged, would be of real value, they are omitted. You find application of funds presented in conventional form when perhaps the only significant change is within the current position and a straight cash statement would be more appropriate. Standard presentations are not necessarily undesirable, but standardization should be a guide rather than an end in itself. Having adopted a basic pattern, statements should be tailor-made as to content if not also as to form, to fit the needs of the individual client. Standard treatment, without unremitting watchfulness, may become the cloak for mental laziness, and simplicity the cloak for ineptitude.

Importance of Income Tax

Incidentally it may be noticed that some of the questions I have posed have a distinct tax flavour. I make no apology for this. Indeed I have often thought it curious that tax, like a surgical operation, is something that may be frankly discussed in private, but not openly referred to except in the most general and dignified terms. Our statute law and the basic accounting and auditing literature were largely developed before the more savage inroads of taxation upon corporate income. It seems only natural, therefore, that income tax has been brought into our accounting presentation only to the extent necessary to reflect the annual cost and the effect upon financial position. As accountants we tend to resist the introduction of tax thinking and methodology beyond the irreducible minimum, except of course when we change character from auditor to tax consultant.

In most cases the conventional year-end statements serve simultaneously several purposes: the basis of tax as-

sessment, management's accounting to shareholders, management's prospectus to the bank, and the accountant's report to management. Perhaps one form of presentation cannot be made to serve all purposes, nevertheless in practice we force the attempt with peculiar results. For years we have taken in our corporate accounts large amounts for depreciation, not because we thought them necessary but because the *Income War Tax Act* specifically required that we do so if maximum tax allowances were to be claimed. Other cases will occur to you where accounting treatment of transactions, ultimately reflected in our all-purpose financial statements, have been influenced by, or indeed dictated by, tax considerations. At the same time, and in the same accounts, we may stubbornly refuse to recognize other tax considerations such as inadmissible capital write-offs, segregation of surplus, and so on. In result, financial statements which have been rendered inadequate for other purposes by reason of tax considerations are not even suitable as an indication of tax position.

I am not saying that this situation always obtains in material measure, but where it does, and where other requirements can be met, it would seem logical to bring accounts into exact agreement with tax treatment, so that we may say "Whatever else these statements may or may not be, they at least reflect the company's income and financial position from a tax standpoint, so far as can be ascertained".

Some Suggestions for Improvement

What, specifically, can we do to improve the statements of smaller companies?

We can do this: when the audit file is complete and the conventional statements prepared, just ask ourselves, "If I were the client and he the auditor, what additional information would I like that can be submitted at reasonable cost?" The adoption of such an attitude would undoubtedly bring into useful focus a deal of information now haplessly buried in filing cabinets to the satisfaction of the audit supervisor but of no one else.

I have mentioned the matter of cost as a factor. Cost is, of course, a factor in the first instance in determining the scope of the examination itself and thereby the amount of information available. Cost is also a factor in determining the scope and form of *report*. My own experience is that the same client who will pay minimum price for minimum service will also pay premium price for premium service, and a continuous educational program can yield results beneficial to both.

I should like to see questionnaires circulated among bankers, corporation lawyers, tax officials, and credit men, as well as our own members, to enquire their opinion as to "What is wrong with the financial statements of smaller companies?" If such a study could be undertaken by the C.I.C.A. Research Committee or some provincial body or committee, the results might prove effective in developing a report check list somewhat similar to the standard audit program that could be referred to as a guide in considering in the individual case what information should be included and what should not. To review this list of available information with the client on the first engagement and thereafter from time to time might suggest additional means of rendering useful service, or alternatively might lead to the elimination of types of information no longer of use. In making this suggestion may I add that from a practical view, in the case of the majority of smaller companies,

the client gets what we think he wants rather than what he may really want. This tendency is perhaps accentuated by the fact that in the pressure of every day practice we tend to relegate the smaller accounts to less experienced staff and in the appraisal of statements for release, the principal or supervisor may unconsciously have an attitude more negative than positive.

Perhaps what is really needed is to change that attitude from negative to positive, realizing that small business is important, not only in a material sense to ourselves, but in a larger sense to the economy of the country.

POT POURRI

Extracts from reports of presidents and chairmen of British companies taken from The Economist,—

Bovril Limited:

"It was no easy matter to know whether it was a good thing in the public interest to make a good profit and earn more revenue for the Treasury, or make a smaller profit and endanger the stability of the company and the livelihood of its employees and shareholders."

Smith's Potato Crisps (1929) Limited:

"The information that is constantly being submitted to us from the trade is strong evidence that if Smith's Potato Crisps were available they are the ones to be supplied. There are no crisps like Smith's."

Vab Products Limited:

"We have also started a practice of ploughing back into subsidiary companies a substantial amount of their profits as a reserve toward future taxation liability. Therefore the picture is more attractive than shown by the actual figures."

J. Lyons and Company Limited:

"The country seems to have become so accustomed to austerity, restriction and control that it is in danger of losing resilience . . . . Critics, we are told, should make plain what they want. Very well then, we want some relief from the spate of legislation to which we have been subjected for so many years. We want freedom to buy what we want, where we want and in the qualities we want. We want freedom to pay high real wages to all who contribute to our effort . . . . We want freedom to pay high real wages not only to our staff, but also to those who supply the necessary capital to enable us to build, to equip, to experiment and to progress."

Recent Books

Taxation in Canada, by J. Harvey Perry; published by The University of Toronto Press, 1951; pp. 402 and index; price $6.00

Mr. Perry's book provides an excellent perspective of the whole field of taxation in Canada at all levels of government. The tax practitioner will benefit chiefly from its analysis of the economic, constitutional, and juridical bases of our tax structure, but it is clear that the book is not intended as a substitute for mere factual sources of information used as tools of the practitioner's trade.

Those who attempt to keep abreast of the shifting front of federal income tax law and regulation will sympathize with Mr. Perry in his attempt to find enduring principles of income tax legislation which are consistently and peculiarly Canadian. On the other hand it will be found that distinctive qualities and developments are revealed in respect to the operation and incidence of the customs tariff. Succession duties, gift and sales taxes, have been treated as phenomena of recent emergence as yet too young to be subject to generalized conclusions.

Of particular interest are those sections tracing the constitutional sources of provincial taxation powers and the origin and scope of federal jurisdiction.

There is an excellent chapter on taxation in Newfoundland and a brief review of municipal taxation in Canada.

Mr. Perry's treatment of the mechanics of federal and provincial budgeting suggest what a laborious and thankless task it is to endeavour to reconcile fiscal need with economic and political necessity.

Mr. Perry has avoided the use of jargon and of scholastic language which so often create insurmountable barriers in technical treatises. The text reads easily and is well sprinkled with asides and comments in lighter vein.

The author has succeeded in casting the wide net, and it may be hoped that he will reach a large audience of taxpayers and their admirers in his effort to dispel the cloud of tax mysteries under which to varying degrees we all labour.

Both lay and professional readers will thank Mr. Perry for a clear and workmanlike exposition of a difficult subject and his further studies on the historical aspects of taxation will be awaited with interest.

DOUGLAS IRWIN, C.A.
Toronto, Ontario

Group Accounts and Holding Companies, by Angus Macbeath and A. J. Platt; published by Gee & Co. (Publishers) Ltd., London; pp. 191 and index; price 17/6

This book has been written to explain the requirements of the U.K. *Companies Act* relating to consolidated (or group) accounts, to discuss the various points of theory arising in the preparation of consolidated statements, and to show by example how consolidated statements are prepared. This should be a very useful text to the U.K. student of accounts or

to the practitioner in that country. The explanation is clear and the arrangement and indexing are admirable. It follows that it will be a useful addition to the library of Canadian accountants whose practice extends to the preparation of accounts for subsidiaries of U.K. companies.

In addition, Canadian accountants may be interested in comparing U.K. with Canadian and American practice. One instance of interest is the apportionment of "goodwill arising on consolidation" between tangible and intangible assets (which was recommended by the Accounting Procedures Committee of the American Institute). Such an apportionment is approved but only when it is possible to change the books of the subsidiary company to reflect the enhanced effective cost to the consolidation of its fixed assets, and it is implied that the balances shown in the books of account of the individual companies must *always* determine the amounts shown in the consolidated statements. Apart from this the accounting practices on consolidation seem to be reasonably consistent with those followed on this side of the Atlantic.

J. R. M. WILSON, F.C.A.
Toronto, Ontario

Income Tax Handbook 1951-52, by Arthur Gilmour, B.Com., C.A., F.C.I.S.; published by Richard De Boo Limited, Toronto; pp. 485; Table of Contents (12) and Index (15); price $7.50

Mr. Gilmour's celebrated income tax handbook, three annual editions of which were published by the Canadian Institute of Chartered Accountants, now reappears, greatly expanded and in beautiful format, under the imprint of Richard De Boo Ltd., after a hiatus of some three years. The new volume retains all the good qualities of the earlier volumes, but of course its supreme merit lies in the fact that it covers the new Income Tax Act enacted in 1948 as well as the Income Tax Regulations. Notwithstanding repeated assurances that the new Act was no more than a consolidation of the old Act the real truth is of course that a great many changes have been made, some substantial and some quite subtle but just as significant, as every practitioner knows only too well.

The book contains chapters on: taxes payable by individuals, income from employment, some special types of income (alimony, annuities, non-arms length cases, etc.), depreciation, deductions from income and from tax, estates and trusts, farmers and fishermen, corporation taxes, distributions of income by companies, consolidated returns, returns, payment and collection of tax, appeals, and non-residents. An elaborate table of contents and index as well as a table of statutes, regulations and orders are supplied. It is sturdily and handsomely bound in pliable red leather, and in format and quality of paper is the finest thing that the publisher has yet turned out.

That there is no chapter on computation of business income, which is perhaps the most important tax problem of all from the point of view of accountants, is perhaps no criticism of a Canadian handbook on income tax, since in the almost total absence of Canadian case law on the subject the commentator must be excessively wary.

M.P.

Accounting Systems: Procedures and Methods, by Cecil Gillespie, M.B.A., C.P.A.; published by Prentice-Hall, Inc. (New York); pp. 811; price $8.65 U.S.

This book describes in detail the various procedures and methods neces-

sary for providing a proper accounting system. It also explains the various forms for recording and for explaining the information so recorded.

The steps which a systems man must follow to determine the extent of the information required is meticulously explained. There is given a form of a letter of transmittal setting up the scope of the work covered together with a chart of accounts and explanatory financial statements.

With regard to methods of accumulating information the book describes in some detail mechanical tabulating equipment, but bookkeeping machine equipment, reproducing equipment, and manual quicksort methods could be more fully outlined.

A possible fault is the failure to describe in sufficient detail the forms and methods required from plant personnel to provide the information necessary either to control factory operations or to satisfy the accounting department. The forms are described to a certain extent, but the industrial accountant must participate in their preparation and must control the basic accumulation of the information.

For those who are interested professionally in systems installations or for the internal accountant who wishes to improve his own methods, this book contains a wealth of information. The illustrated forms accompanying each chapter are excellent and the author deserves great credit for the quantity and quality of this very important descriptive material.

The book is the best of this type the reviewer has had the opportunity of reading. For the individual with experience it has excellent reference material and for the beginner it would be of great value as text material.

JAS. B. TENNANT, R.I.A.
Ingersoll, Ontario

The Canada Year Book 1951; published by the Dominion Bureau of Statistics, Ottawa; pp. 1300; price $3.00 cloth-bound, $1.50 paper-bound

The Dominion Bureau of Statistics announces that the 1951 edition of The Canada Year Book is now obtainable from the King's Printer, Ottawa. This year's edition contains special articles on Canada's forest economy, early naturalization procedure and events leading up to *The Citizenship Act*, the Indians of Canada, and the conversion program to 60-cycle power in southern Ontario.

The paper-bound copies are available at $1.50 to *bona fide* teachers, university students, and ministers of religion from the Dominion Statistician, Dominion Bureau of Statistics.

Research Bulletin No. 7

THE AUDITOR'S RESPONSIBILITY FOR THE VALIDITY OF THE INVENTORY FIGURE

Bulletin No. 7 of the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants, issued October 1951

IN order to offer what assistance it can to the profession, the Committee on Accounting and Auditing Research has undertaken to answer selected questions on auditing topics which have been submitted for its consideration. The following question has been considered by the Committee:

> *Do the words, "as determined and certified by the management", appearing on a balance sheet in connection with the valuation of an inventory, whether or not supported by the certificate usually obtained from the management, relieve the auditor of responsibility for the validity of the inventory figure, and if not, what is the auditor's responsibility?*

Section 112(1) of *The Companies Act, 1934* (*Canada*) requires the directors to lay before the company at each annual meeting a balance sheet, a "general statement of income and expenditure", and a statement of surplus in addition to the report of the auditor. Fundamentally, therefore, the financial statements are those of the directors, whether or not they are in fact prepared by the auditor; the auditor is reporting upon the statements as prepared.

Section 112(2)(d) of *The Companies Act 1934* (*Canada*) provides that the inventory must be shown separately on the balance sheet "stating the basis of valuation adopted and the manner in which such value has been determined in respect of various sub-divisions of such inventory". In those instances where inventories are stated to be "as determined and certified by the management" such phraseology can only be regarded as a part of the financial statements presented by the directors and designed to comply with the provisions of section 112(2)(d).

In the opinion of the Committee it follows that the inclusion in the balance sheet of the words "as determined and certified by the management" or words of similar import with reference to the inventory does not relieve the auditor of responsibility.

The Auditor's Responsibility

The law as to the auditor's responsibility for the validity of the inventory figure is not extensive and the leading cases were decided many years ago under conditions greatly different from those prevailing today. While this responsibility cannot be readily defined, the auditor should use at least that degree of care, skill, and judgment, which might reasonably be expected from a person trained to carry out such a responsibility, having regard to the general standard of practice prevailing at the time. Thus

the auditor will determine, in the light of the particular circumstances, those inventory procedures which must be undertaken to enable him to express an opinion upon the financial statements.

Procedures in Canada

In the opinion of the Committee, generally accepted auditing procedure in Canada in respect of inventories does include (1) a review of the methods followed in the determination of quantities and values, (2) the testing of the inventory quantities with confirmatory evidence such as rough count sheets, perpetual stock records, etc., and (3) the testing of the pricing of the inventory and its clerical accuracy. This test must be sufficient in scope to satisfy the auditor that the stated basis is being followed and to determine whether the basis is consistent with that of the previous year.

Except in the case of companies filing with the Securities and Exchange Commission in the United States, it cannot be said that generally accepted auditing procedures in Canada at the present time require attendance by the auditor at the physical stocktaking. However, there is an increasing tendency on the part of auditors in Canada to adopt this practice because of its usefulness in evaluating the system of internal control. It is not usual in Canada to include in the auditor's report any notation or qualification if the auditor has not attended at the physical stocktaking.

If the auditor is reporting on the accounts of a company in Canada which has to file with the Securities and Exchange Commission of the United States the procedures must include at least those regarded as generally accepted in the United States. As will be seen from the Appendix, these include attendance at the physical stocktaking wherever such procedure is practicable and reasonable, and the inventory is material in amount, and also require an exception as to the scope of his examination to be set forth in the auditor's report if he has not attended at the stocktaking, even though he has satisfied himself by other means.

APPENDIX

Procedures in the United Kingdom

In the United Kingdom no procedures regarding the audit of inventories have been laid down either under the *Companies Act* or by the professional accounting societies. While professional literature published in the United Kingdom indicates that the practice of attending at the physical stocktaking is followed on occasion and has proved useful in many instances it is not yet regarded as a generally accepted auditing procedure in that country.

Procedures in the United States of America

The Committee on Auditing Procedure of the American Institute of Accountants has issued a "Codification of Statements on Auditing Procedures". The following excerpts have been taken from this Codification.

RESPONSIBILITIES AND FUNCTIONS OF THE INDEPENDENT AUDITOR

The independent auditor's function is to examine a concern's accounting records and supporting data, in certain matters to obtain outside confirmations, and to require and consider supplementary explanations of management and employees, to the extent necessary to enable him to form an opinion as to the fairness of the financial statements as submitted.

In no sense is the independent certified public accountant an insurer or guarantor, nor do his training and experience qualify him to act as a general appraiser, valuer, or expert in materials.

* * *

EXTENSIONS OF AUDITING PROCEDURES

At the 1939 annual meeting, the membership of the Institute approved the ex-

tension of auditing procedures to require observation of inventories and confirmation of receivables where either of these assets represents a significant proportion of the current assets or of the total assets of a concern. These procedures were thus established as an integral part of generally accepted auditing procedures. Failure to apply them, where they are practicable and reasonable, in general precludes expression of an opinion on the fairness of the financial statements taken as a whole.

The procedures, it will be noted, must be *both* practicable and reasonable. In the province of auditing, *practicable* means "capable of being done with the available means" or " . . . with reason or prudence", *reasonable* means "sensible in the light of the surrounding circumstances".

* * *

In all cases in which the extended procedures are not carried out with respect to inventories or receivables at the end of the period or year, and they are a material factor, the independent certified public accountant should disclose, in the general scope section of his report, whether short or long form, the omission of the procedures, regardless of whether or not they are practicable and reasonable and even though he may have satisfied himself by other methods.

In the rare situation in which they are applicable and are not used and other procedures can be employed which will enable him to express an opinion, he should, if the inventories or receivables are material in amount, disclose the omission of the procedures in the general scope paragraph without any qualification in the opinion paragraph with respect to such omission. In deciding upon the "other procedures" to be employed he must bear in mind that he has the burden of justifying the opinion expressed.

Where the procedures are applicable but are not used and he has not satisfied himself by other procedures he should, if the amount is significant, disclaim an opinion on the fairness of the statements as a whole; except that where the amount with respect to which he is unable to satisfy himself is not sufficiently material to preclude an expression of opinion on the statements as a whole but is nevertheless important enough to deserve mention, he may make a specific exception in the opinion section of the report as to this amount.

* * *

Inventories

The extended procedures as to inventories are as follows:

Where the independent certified public accountant intends to report over his signature on financial statements in which inventories are a material factor, in addition to making auditing tests and checks of the inventory accounts and records, he shall, wherever practicable and reasonable, be present, either in person or by his representatives, at the inventory-taking and by suitable observation and inquiry satisfy himself as to the effectiveness of the methods of inventory-taking and as to the measure of reliance which may be placed upon the client's representations as to inventories and upon the records thereof. In so doing he may require physical tests of inventories to be made under his observation.

Where the inventory is determined solely by means of a physical inventory at the end of the accounting period (or at a date before or after but reasonably close to that date, with adequate records supporting the changes during the intervening period), it is ordinarily necessary for the foregoing procedures to be followed at that time.

Where well kept and controlled perpetual inventory records are maintained, supported by (1) a complete physical inventory at a date not coincident with the balance-sheet date, or (2) physical inventories of individual items taken from time to time so that the quantity of each item on hand is compared with the related inventory record at least once in each year, it is satisfactory to undertake the procedures outlined at any interim date or dates selected by the independent auditor, his purpose being to satisfy himself as to the credibility of the perpetual inventory records and the reliance that may be placed on them in supporting the inven-

tory totals as shown in the balance-sheet.

In the case of inventories which in the ordinary course of business are in the hands of public warehouses or other outside custodians, direct confirmation in writing from the custodians is acceptable provided that where the amount involved represents a significant proportion of the current assets or of the total assets, supplemental inquiries are made to satisfy the independent auditor as to the bona fides of the situation.

The independent auditor does not "take", "determine", or "supervise" the inventory. These operations are undertaken by management, antecedent to its primary representations concerning quantity, condition, and value. He observes and tests these procedures in his capacity as independent auditor, but he does not, and should not in his ordinary capacity as an independent auditor, make the original determination. He gives consideration to the effectiveness of the internal control as applied not only to the book records but also to the procedure of taking physical inventories. His functions do not include those of a general appraiser, valuer, or expert in materials.

CRICKET

One of the more fascinating mental exercises for a non-cricketer is to find the correct interpretation of the phrases used by sports-writers who know the game. The difference between these writers and sports-writers on this continent, who use slang or a colloquialism which is completely unintelligible to the uninitiated, is that the writer on cricket preserves all the amenities of the English language but frequently uses them in a reverse direction.

Some of us, with but a very slight knowledge of the rules of cricket, recently spent a most entertaining Saturday morning (we are of the class who have to work on Saturdays) solving the following problem,—

> With eight minutes left to play and with the last man in, the Chartered Students required 35 runs to win. The batsmen, however, defied all the bowlers' attempts to force a win, and the match ended in a draw.

This is the type of problem in which the answer is obvious after you find it!

A Letter from A Reader

Toronto, Oct. 9, 1951

THE AUDITOR'S REPORT

Sir: Bulletin No. 6 issued by the Committee on Accounting and Auditing Research is a document of much concern to companies and their shareholders and to auditors.

Its outstanding submission is the standard form of report, but exceeding this in significance is the claim in the first paragraph, "the primary purpose in such an appointment is to obtain from the auditor an expression of his opinion as to whether or not the financial statements of the organization exhibit a true and correct view of the state of its affairs". In my opinion this statement of the primary purpose of an auditor's appointment confines the function of the auditor within limits which are much too narrow. The proprietor of a business or a shareholder is interested in the transactions of his concern throughout the financial period as well as in its position at the period end. The auditor is appointed for the period.

The paragraph in the bulletin dealing with the scope of the examination reflects the same limited objective in stating that supporting evidence is required only to show the correctness of the statement of affairs at a given time. Even here the auditor is told that he may rely on internal control and accounting methods.

The committee states that it examined many reports and found "no generally accepted wording for these reports" and because the committee believes that the differences in wording may confuse the reader, it presents a standard form to be used except in special cases. In my view it is very doubtful that a standard form is desirable, but if it were, a form much stronger in its import should be adopted.

To me, the fact that uniformity does not prevail in the reports now to be found in published statements is encouraging. Auditors who consider that their undertaking is to audit the books of account will still prefer to say in their report that they have done this. The "standard" report recommended by the committee fails to make any admission on that point. In the recommended report the auditor states that he has "examined" the balance sheet and statement of profit and loss and surplus. But he admits having obtained some information; in fact that he has obtained all that he required in the way of information and even received explanations. He adds, too, that his examination included a review of procedures, but, to prevent his review from being too generously interpreted, he calls it a "general" review. Further, he states that this examination of the balance sheet, etc., included such tests of accounting records and other supporting evidence as he considered necessary in the circumstances. It is not suggested that the tests were for accuracy of the book entries or to find that these were proper. The extent of the tests is not given: he simply says that they were what he considered necessary, adding the final words of emasculation "in the circumstances".

The auditor's opinion is quite boldly stated as to the true and correct view of the state of affairs and the results. With delightful naïveté this opinion is qualified by the words "according to the best of my information and the explanations given to me", which by our reading of the first paragraph, may be meagre indeed. Then at the end he says "and as shown by the books of the company". The auditor's meaning here must be, that, not only do the balance sheet and statements agree with what he was told, but they agree with the books of the company. He audits not, neither does he spin, but that much he will say. The last paragraph of the bulletin deals with limitations in exam-

ination. Here it is indicated that where the auditor is satisfied that his examination is adequate, it is unnecessary for him to mention special limitations in his audit.

If the auditor understands his responsibility to be the auditing of the books of account, he should say in his report that he has audited the books of account or he should say that he has not. As to the range and depth of his auditing, he himself will decide. He might not examine every transaction but he has seen what he wished to examine, knowing that whether he audits by general or by detailed scrutiny, he must state in his report that he has audited the books of account.

If the Canadian Institute takes a hand in guiding its members as to their audit reports, it should confine itself to stating general principles. If a standard form of report be offered the form should present the highest type of audit report representing the result of the best auditing practice, and it should be free from shielding terms of evasion. The form given in the bulletin seems deliberately to shy away from auditing.

JAMES TURNER, C.A.,
Toronto, Ontario

Professional Notes

ALBERTA

Clarkson, Gordon & Co., Chartered Accountants, announce the admission to partnership of Mr. Donald A. McGregor, C.A., Calgary.

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Patriquin, Duncan, McClary, McClary & Co., Chartered Accountants, Thomson Bldg., Edmonton, announce the admission to partnership of Messrs. John E. Williams, C.A., J. Roy Leard, B.A., B.Acc., C.A., Ross H. Gould, C.A., and L. Stanley Pollard, C.A. They also announce the opening of a South Edmonton office at 10444 82nd Ave., Edmonton, with Mr. John E. Williams, C.A. as resident partner.

Calgary Chartered Accountants Club

The annual meeting of the Calgary Chartered Accountants Club took place on October 3 in the Palliser Hotel. Reports were received and the following officers were elected for the coming year: *president,* H. H. Love, C.A.; *vice-president,* R. E. Waller, C.A.; *secretary-treasurer,* J. C. Fowler, C.A.; *directors,* A. Johnson, C.A. and R. E. Waller, C.A.; *auditor,* J. Fish, C.A.

BRITISH COLUMBIA

Frederick Field & Co., Chartered Accountants, Royal Bank Bldg., Vancouver and New Westminster, announce the admission to partnership of Messrs.. Norman M. Crute, C.A., Clarence S. Nicholl, C.A., Frederick Graham, C.A., H. Frederick Field, B.A., B.Com., C.A.

* * *

Mr. V. Randolph Clerihue, C.A. announces the admission to partnership of Mr. W. R. Clerihue, B.Com., C.A. Henceforth the practice of the profession will be carried on under the firm name of Clerihue & Clerihue, Chartered Accountants, with offices at Rms. 32-3, 640 W. Hastings St., Vancouver.

MANITOBA

Sharp, Woodley & Co., Chartered Accountants, Winnipeg, announce the admission to partnership of Messrs. W. Gordon Dunbar, C.A. and E. Wilfrid Sharp, C.A.

NEW BRUNSWICK

New Brunswick Institute Students Society

Moncton Branch

The first meeting of the Moncton Branch of the N.B. Institute Students Society was held recently at Dunham's. Special guests for the evening were Mr. H. M. Stevens, manager of the Moncton branch of G. E. Leslie & Co. and Mr. George Hudson, C.A. senior partner of Hudson, McMackin & Co. George Steeves was chairman of the meeting and Allan Robidoux thanked the speakers.

Moncton Chartered Accountants Club

Mr. A. Emile Beauvais, C.A., president of the C.I.C.A., was a recent guest of honour at a luncheon given by the Moncton Chartered Accountants Club. Mr. Beauvais was on a tour of the Maritimes accompanied by Mrs. Beauvais and Mr. C. L. King, F.C.A., secretary of the C.I.C.A. Mr. Walter Dick, C.A. presided at the luncheon.

NEWFOUNDLAND

While on a tour of the Maritime Institutes in October, Mr. Emile Beauvais, Mme Beauvais, and Mr. Clem L. King were entertained at lunch at Bob Barkley's tea room in Brigus. Following a meeting with the members of Council of the Newfoundland Institute in the afternoon of the same day, the ladies entertained Mme Beauvais at dinner and bridge, while Mr. Beauvais and Mr. King attended a dinner meeting of the Institute. Mr. Beauvais outlined to the meeting some

of the major activities being undertaken by the C.I.C.A. in the interests of the members and expressed the hope that the Newfoundland Institute would be able to participate fully in these activities. Mr. R. B. Moyse, president of the Newfoundland Institute, presided at the meeting.

ONTARIO

Ontario Institute

A supper dance and cabaret was held by the Institute of Chartered Accountants of Ontario in the Royal York Hotel, Toronto, on Thursday, November 8th. The guests were received by Mr. and Mrs. J. A. Wilson, Mr. B. A. Armstrong and Mr. and Mrs. W. L. McDonald. Over four hundred were present, and the Committee, under the chairmanship of Mr. John Craig, is to be congratulated on the excellent arrangements. The marionette show by the "Marquettes" was particularly entertaining.

Ontario Students' Association

The Chartered Accountants Students' Association of Ontario held a very well attended dinner meeting in Toronto on Monday, November 5th. R. B. Moran, C.A., the President of the Argonaut Rowing Club, introduced Mr. John Kerns, the playing coach of the Argo football team, Mr. Knobby Wirkowski and Mr. Doug Smylie. Mr. Kerns gave a short talk and commentated on moving pictures which were shown of Argo games.

Hamilton and District C.A. Association

The first dinner meeting for the current season of the Hamilton and District Chartered Accountants' Association was held at the Officers' Club on October 10 with 60 members in attendance. The meeting took the form of a panel discussion on the subject of "Marginal Costs". The speakers were Messrs. Kenneth Smith, George Moller, R. D. Isbister and M. S. Sutherland. Mr. H. C. Dixon acted as chairman. Following the principal speeches, a lively discussion took place concerning the merits of the technique of marginal costing as an administrative device.

The November meeting of the association, which was addressed by Mr. W. F. Lougheed, economist of the Canadian Bank of Commerce, was a dinner meeting.

Windsor and District C.A. Association

The regular monthly meeting of the Windsor and District Chartered Accountants Association was held on October 22, 1951 at Burroughs Adding Machine Company, Detroit, Mich. Mr. James Lillis, C.P.A., controller of the Burroughs Company, spoke to the members and gave a demonstration of accounting machines.

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Clarkson, Gordon & Co., Chartered Accountants, announce the admission to partnership of Messrs. John L. Biddell, C.A. and G. Kenneth Carr, C.A., both of Toronto.

* * *

Mr. Louis R. Desmarais, B.Com., C.A., announces the opening of an office for the practice of his profession at 4 Durham St. N., Sudbury.

* * *

Mr. Charles W. Pearson, C.A. announces the admission to partnership of Mr. D. J. Matthews, C.A. Henceforth practice of the profession will be conducted under the firm name of Pearson and Matthews, Chartered Accountants, with offices in the Gummer Bldg., Guelph.

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David Vise & Co., Chartered Accountants, Bank of Nova Scotia Bldg., Toronto, announce the admission to partnership of Messrs. Max Soberman, C.A. and Hy. Isenbaum, C.A.

* * *

Mr. Clarence S. McLaren, C.A. announces the opening of an office for the practice of his profession at Rm. 35-36, 53 Queen St., Ottawa.

PRINCE EDWARD ISLAND

1951 Conference of Maritime Chartered Accountants

Members of the P.E.I. Law Society and local bank managers were special guests when Mr. Monteath Douglas, executive director of The Canadian Tax Foundation, addressed the

1951 conference of Maritime chartered accountants on "Current Trends in the Federal Tax Field". This conference was held on October 11 and 12 in The Charlottetown Hotel.

Other speakers at the technical sessions included Messrs. Brenick Sears and Randolph W. Manning, both Maritime chartered accountants, and Mr. D. R. Pook, director of the Finance and Service Section of the Income Tax Division, who spoke on the development of the capital cost allowances regulations. Mr. A. Emile Beauvais, C.A., president of the C.I.C.A., discussed technical matters of general interest to the profession and Mr. Gerald E. Martin, regional representative on the C.I.C.A., outlined the work of the C.I.C.A.'s Committee on Accounting and Auditing Research.

The closing dinner meeting was addressed by Dr. Frank MacKinnon, M.A., Ph.D., principal of Prince of Wales College, who spoke on "Opinion and Imagination".

QUEBEC

M. Jean La Tour, comptable agréé, annonce qu'il pratique sa profession à 37, rue de la Couronne, chambre 305, Québec.

Quebec Students' Society

The Chartered Accountants Students' Society of Quebec held its opening dinner meeting at the Queen's Hotel, Montreal, October 16, with 114 members present. Mr. H. Heward Stikeman, K.C. spoke on "What Is Income?" The meeting was chaired by Mr. Russell Bremner, C.A.

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M. Ls-Philippe Dagenais, C.A. annonce que son bureau est maintenant démenagé à 448 Ave. Brookfield, Ville Mont-Royal.

SASKATCHEWAN

Rooke, Thomas & Co., Chartered Accountants, and W. M. Vicars & Co., Chartered Accountants, announce that their practices have been combined and are being carried on under the firm name of Rooke, Thomas & Co. with offices in The Leader-Post Bldg., Regina.

Saskatoon C.A. Association

At the October dinner meeting of the Saskatoon Chartered Accountants Association, the registered students of Saskatoon were guests of their respective employers. Dean J. H. Thompson, F.C.A., of the University of Saskatchewan, spoke on the new course of study adopted by the Institute. Dean Thompson also explained the method of setting and marking of examination papers. S. O. McMillan, C.A., briefly outlined the constitution of the Saskatoon Students Society. C. J. Kirkpatrick, C.A., member of the Institute's Student Committee, stressed the importance of an active Student Society, and urged that the students continue to keep their organization as strong as possible.

Mrs. Eva M. Leger, C.A., president of the Saskatoon Chartered Accountants Association, presided.

News of Our Members

Mr. A. Irving Barrow, C.A. (N.S.), has been elected president of the Halifax Commercial Club.

* * *

Mr. Reg. J. Dawson, C.A. (Que.), is a candidate for the mayoralty of the Town of Mount Royal, Que.

Mr. A. J. Frost, C.A. (Ont.), has been appointed manager of the Ottawa branch of the Toronto General Trusts Corporation.

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Mr. A. G. Rankin, C.A. (Ont.), has been appointed comptroller of the University of Toronto.

Mr. George S. Currie, C.A. (B.C.; Que.) partner in McDonald Currie & Co., Chartered Accountants, has been elected a director of Merck & Co., Rahway, N.J.

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Messrs. W. J. Macdonald, C.A. (Man.), and Ward McVey, C.A. (Man.), were recently honoured by the Manitoba Pool Elevators for their outstanding services to the pool organization.

Mr. D. A. Ross, C.A. (Alta., B.C.), has been appointed executive vice-president of Canada Bread Co., Toronto.

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Dr. Chester Walters, D.F.Sc., LL.D., C.A., C.P.A., had the honorary degree of doctor of laws conferred on him at the fall convocation of the University of Western Ontario.

Obituaries

Major Miles Birkett

The Institute of Chartered Accountants of Quebec announces with regret the death of Major Miles Birkett on October 12, 1951.

He was born at Providence, R.I., March 27, 1864 and came to Canada in 1880 to study at the National Business College, Ottawa, where he subsequently became a teacher. He removed to Montreal in 1900 and entered the public accounting field on his own account in 1910. He was one of the organizers of the Institute of Accountants and Auditors, of which he was a charter member, and was admitted to membership in the Quebec Institute under the provisions of the Act regulating the practice of accountancy and auditing passed by the Quebec Legislature in 1946.

His interests were military and masonic. For 57 years he was past master of Dalhousie Lodge 52, Ottawa, and was one of the oldest past members of the Ontario Jurisdiction. He was also active in church affairs.

To his son, Norman Miles Birkett, the members of the Institute extend their sincere sympathy.

Walter Charles Murphy

The Institute of Chartered Accountants of Quebec reports with deep regret the death of Walter Charles Murphy, age 41, who was killed instantly on November 7, 1951, when his car skidded and hit the centre pillar of the viaduct on Hochelaga Street, Montreal, during a blinding snowstorm. The car was a total wreck.

Educated in Montreal, the late Mr. Murphy joined the firm of Sharp, Milne & Co. in 1929 and after completion of his service and studies at McGill University, passed the final examination and was admitted to membership in June 1935. He subsequently was associated with the Dominion Rubber Company and in 1945 joined the firm of E. C. Leetham & Company. He later severed his connection with the latter company and for several years had been practising on his own.

The news of Mr. Murphy's tragic and untimely death came as a great shock to the members of the Institute, who extend their sincere sympathy to his widow and children.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

AS WE SEE IT the role of the "layman" or the "man in the street" is largely invidious. He is supposed to represent such a low level of learning that almost any member of any special group can use him as a standard of comparison and obtain a boost in morale.

This being so, the situation becomes embarrassing indeed when the "man in the street" uses specialized terms with such persistence that the loose meaning he ascribes to them extends even to the minds of those whose tools they are. We are rather afraid this is what has happened to a few accounting terms.

Now the "man in the street" typically refuses to take a concept for what it is. He materializes all concepts into earthly things because he has not the mental discipline to do otherwise. In this way he succeeds in creating for himself and for others whom he influences a kind of fool's paradise where everything seems much easier than it really is and nobody quite understands what he is doing.

The dictionary defines a concept as "an abstract general notion or idea". It is, therefore, something in one's mind and quite without any existence elsewhere. We submit that there are a few accounting concepts that are sacred and which it is sacrilege to try to clothe with a tangible existence.

Two of the accounting concepts we have in mind, for example, are *profit* and *surplus*. They have a specialized meaning that should be dictated by the accountant and not by the man in the street. Nevertheless both profit and surplus are commonly identified for convenience with money in the bank even by those who should know better. It is a commonplace to say that a proprietor withdraws profits from his business for living purposes. But we protest that most proprietors, let alone their families, are not mystic enough to subsist indefinitely on "abstract general notions or ideas". Of course what the proprietor really withdraws are the rather more tangible contents of his cash register. Likewise we often hear it said (and this one really makes us wince) that a business is "making money". Cannot we say the business is earning profits or do we not know what profits are? Indeed we have met those who have said that a limited company pays out *surplus* as dividends; but of course we are no longer on speaking terms with these people.

* * *

Surely another maltreated accounting concept is the poor *asset*. Part of the trouble arises because of the convention of classifying all assets (except a very few recalcitrant ones) as either "fixed" or "current". We have pleaded previously in these *Notes* that a more meaningful classification of assets would be between cash and claims to cash (accounts receivable and bond investments) on the

one hand and unexpired costs (merchandise inventory, prepaid expenses and fixed assets) on the other hand. For us this classification at least brings out more of the true nature of an asset.

The point we are trying to make here is that an asset cannot be both an unexpired cost *and* a physical object at one and the same time. This may seem like a trite thing to say but it is nevertheless a mistake many people make. For those assets that may be classified as unexpired costs the "asset" is really the *cost* of the object or property and not the object itself. For example the asset described as "building" is in fact the undepreciated *cost* of a building and not a combination of bricks, mortar, lumber, and shingles.

The unfortunate habit of thinking of assets in terms of physical objects is continually embarrassing the accountant. Once one slips into the way of thinking of assets *as* physical objects he must inevitably suffer misgivings about balance sheet figures that fail to reflect the current worth of the objects in mind. There is not much point after all in listing a real object at an unreal figure. The difficulty would be avoided if we thought of, and described, assets as "unexpired cost of merchandise", "unexpired cost of buildings", etc. and not merely "merchandise", and "building".

* * *

Of course a *cost* is itself a concept. We would define a cost as the amount of money needed to pay for goods or services acquired for the purpose of earning revenue. It is to be noted, however, that the revenue so to be earned may relate to one or more accounting periods, and that cash will not be needed immediately if the goods or services are acquired on credit.

SOLUTION TO NOVEMBER'S PUZZLE

R A S C A L
A C T I V E
S T A G E S
C I G A R S
A V E R S E
L E S S E N

EASY PUZZLE FOR DECEMBER

(*A Christmas Present*)

A boy says, "I have as many brothers as sisters." His sister answers, "I have twice as many brothers as sisters." How many brothers and sisters are there in the family?

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect of course the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussions of solutions presented are cordially invited.

PROBLEM 1

Final Examination, October 1950

Accounting III, Question 5 (8 marks)

The town of FF erects a town hall from the proceeds of bonds issued for the purpose. It is estimated that the building will last 30 years. The bonds also mature in 30 years and contain a sinking fund clause to provide the funds for their payment at maturity.

No provision for depreciation on the building has been made in the annual tax rate and a controversy arises in the town council as to whether such a provision should be made.

Required:

State your views on the subject.

A SOLUTION

The effect of taking depreciation expense into account in setting a tax rate is to ensure that over the estimated life of the asset revenues will be sufficient to bring in funds equal to the cost of the asset, and so to provide at least that amount towards the replacement of the asset at the end of its estimated useful life.

On the other hand in the present case the sinking fund provision is in effect the equivalent of depreciation. The sinking fund will earmark funds that can only be used for the purpose of redeeming the bonds. To include depreciation as well in setting the tax rate would be to require present taxpayers to pay for the town hall as it is used and in addition to pay for its replacement for the benefit of a future group of taxpayers.

PROBLEM 2

Final Examination, October 1950

Accounting III, Question 6 (20 marks)

BB and CC entered into partnership on 1 January 1946, sharing profits and losses in the ratio of BB:CC=3:2 and invested $100,000 and $90,000 respectively. On 1 Jan 1947 BB invested a further $25,000 and CC a further $20,000. On 1 Jan 1948 DD was admitted to the partnership. DD invested $100,000 for a 20% interest in the capital after his admission (the capital accounts of BB and CC having been adjusted by the goodwill indicated from the contributions of DD), and it was agreed that future profits and losses should be in the ratio of BB:CC:DD=5:3:2. BB agreed to transfer $10,000 from his to CC's capital account in consideration for the change in the profit distribution as between BB and CC.

On 3 Dec 1947, as the result of an appraisal, the net recorded value of the building owned by the firm was increased by $50,000.

Profits of the partnership and drawings of the partners for the four years ended 31 Dec 1949 were:

	BB Drawings	CC Drawings	DD Drawings	Profits
Year ended 31 Dec 1946	$12,000	$10,000	$ —	$42,000
" " " 1947	15,000	15,000	—	57,000
" " " 1948	18,000	16,000	15,000	87,000
" " " 1949	18,000	16,000	15,000	96,000

On 2 Jan 1950 the BCD Co. Ltd. was formed to take over the assets and assume the liabilities of the partnership BB, CC and DD in return for fully paid common shares of the company with a par value of $10 each. Assets and liabilities are to be transferred

at their recorded value on the books of the partnership, except that the partnership books are to be adjusted in respect of:

(a) An undervaluation of the inventory as at 31 Dec 1947 of $8,000.

(b) An overvaluation of the inventory as at 31 Dec 1949 of $14,000.

(c) Goodwill. The goodwill of the partnership is to be calculated as the amount by which 200% of the average annual profits from 1946 to 1949 inclusive exceeds 10% of the capital, excluding goodwill, of the partnership as at 31 Dec 1949. BB, CC and DD propose that their salaries from the BCD Co. Ltd. shall be $12,000, $10,000 and $8,000 per annum respectively. In calculating the goodwill of the partnership the annual profits are to be adjusted accordingly.

Required:

A statement showing, in detail, the computation of the value and number of shares of the BCD Co. Ltd., that each of the partners BB, CC and DD should receive in accordance with the foregoing.

A SOLUTION

Computation of Partners' Capital Accounts

as at 31st December 1949

	BB	CC	DD
1 Jan 1946—investment	$ 100,000	$ 90,000	$
31 Dec 1946—profits $42,000	25,200	16,800	
	125,200	106,800	
31 Dec 1946—drawings	12,000	10,000	
	113,200	96,800	
1 Jan 1947—investment	25,000	20,000	
31 Dec 1947—appraisal	30,000	20,000	
31 Dec 1947—profits $57,000	34,200	22,800	
	202,400	159,600	
31 Dec 1947—drawings	15,000	15,000	
	187,400	144,600	
1 Jan 1948—goodwill and admission of DD	40,800	27,200	100,000
1 Jan 1948—adjustment of accounts	(10,000)	10,000	
31 Dec 1948—profits $87,000	43,500	26,100	17,400
	261,700	207,900	117,400
31 Dec 1948—drawings	18,000	16,000	15,000
	243,700	191,900	102,400
31 Dec 1949—profits $96,000	48,000	28,800	19,200
	291,700	220,700	121,600
31 Dec 1949—drawings	18,000	16,000	15,000
	273,700	204,700	106,600

31 Dec 1949—adjust undervaluation of $8,000	(4,000)	(2,400)	(1,600)
—inventory 31 Dec 1947	4,800	3,200	
31 Dec 1949—adjust overvaluation of $14,000			
—inventory 31 Dec 1949	(7,000)	(4,200)	(2,800)
	267,500	201,300	102,200
31 Dec 1949—goodwill adjustment from $68,000 to $31,700	(18,150)	(10,890)	(7,260)
31 Dec 1949—capital as adjusted	$ 249,350	$ 190,410	$ 94,940
Shares in BCD Co. Ltd. @ $10 each	24,935	19,041	9,494

Computation of Goodwill

Year	Adjusted Profits	Assumed Salaries	Assumed Net Profit
1946	$42,000	$22,000	$ 20,000
1947	65,000	22,000	43,000
1948	79,000	30,000	49,000
1949	82,000	30,000	52,000
			$164,000

Average assumed annual net profit	$41,000
200% thereof	82,000
10% of capital as at 31 Dec 1949	50,300
Goodwill	$31,700

PROBLEM 3

Final Examination, October 1950

Auditing I, Question 1 (22 marks)

(a) One of the procedures in the auditor's verification of the statement of profit and loss of a manufacturing concern consists of the examination of the relative balance sheet accounts. State which balance sheet accounts, in relation to the undernoted profit and loss items, the auditor should examine, giving reasons.

(i) Sales

(ii) Cost of goods sold and expenses

(b) List the types of analytical procedures that the auditor should adopt in the verification of the statement of profit and loss.

A SOLUTION

(a)

(i) *Sales*

(1) Accounts receivable account — to ascertain that all sales were bona fide sales and not consignment shipments, and to ascertain that there were no material returns subsequent to the year end.

(2) Inventory accounts — to ensure that merchandise was not both included in year end inventory and put through as a sale, and to ensure that all shipments not included in year end inventory were in fact put through as sales.

(3) Allowance for quantity discount account — to ensure that the full liability has been set up for the discount unpaid and accruing on sales (where a discount is normally paid or credited periodically on the basis of volume of sales in the period).

(4) Deferred income account — to ensure that a correct amount was taken into income for the period on instalment sales, prepaid subscriptions, etc.

(ii) *Cost of goods sold and other expenses*

(1) Inventory account — to ensure (a) that the method of valuation has been consistent with the valuation of the opening inventory, including the consistency of charging factory service to inventory and (b) that all goods inventoried were actually set up in the accounts and that all goods set up were inventoried.

(2) Accounts payable account — to ascertain that all expenses were applicable to the period and that liability for all goods and services received was set up.

(3) Prepaid expenses account — to ascertain that prepayments have been calculated on a basis consistent with that used at the start of the period so that expenses of the period will have been measured properly.

(4) Fixed asset accounts — to ensure (a) that the policy of charging costs to fixed asset accounts is consistent with the previous year and is reasonable and (b) that all disposals and assets scrapped were written out of the accounts and the proper profit or loss on disposal taken into income account.

(5) Allowance for depreciation accounts — to ascertain that the basis of calculating depreciation is consistent.

(6) Accrued liabilities account — to ensure that the basis of accruing expenses (e.g. wages) is consistent with the prior year and that all accruals have been set up.

(7) Deferred charges account — to ensure that any amortization was reasonable and consistent.

(8) Bank loan, bonds payable, and notes payable accounts — to ascertain that the correct interest expense has been charged to the period.

(b)

(1) Compare revenue and expense items with previous years' figures and analyze all significant differences.

(2) Compare revenues and expenses expressed as percentages of sales with corresponding percentages of previous periods and obtain an explanation of significant differences.

(3) Where applicable, analyze revenue and expense per product manufactured and sold, and compare with previous years.

(4) Analyze revenue and expense accounts to ensure that the company's accounting practice has been consistent with prior years.